No. 81-79

Office-Supreme Court, U.S.
FILED
DEC 24 1981
ALEXANDER L. STEVAS,
CLERK

IN THE

Supreme Court of the United States

October Term, 1981

IN RE STATE OF MISSOURI, et al.,

Petitioners,

—v.—

UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF ARKANSAS and the HONORABLE CHARLES W. BAKER, et al.,

Respondents.

PETITIONERS' REPLY TO BRIEF FOR THE UNITED STATES

Dated: December 23, 1981

JOHN ASHCROFT
Attorney General

MICHAEL H. FINKELSTEIN
Assistant Attorney General

P.O. Box 899
Jefferson City, Missouri 65102
(314) 751-3321

Attorneys for Petitioners

Of Counsel:

RICHARD LIEB
KRONISH, LIEB, SHAINSWIT,
WEINER & HELLMAN
1345 Avenue of the Americas
New York, New York 10105
(212) 841-6000

TABLE OF AUTHORITIES

Cases:	Page(s)
Boese v. *King*, 108 U.S. 379 (1883)	2
Chandler v. *Judicial Council of Tenth Circuit*, 398 U.S. 74 (1970)	10
Ex Parte The City Bank of New Orleans, 44 U.S. (3 How.) 292 (1845)	10
Matter of Emergency Beacon Corporation, Slip Op. p. 5387 (2d Cir. November 23, 1981)	7
International Shoe Company v. *Pinkus*, 278 U.S. 261 (1929)	2, 3
Isaacs v. *Hobbs Tie & Timber Company*, 282 U.S. 734 (1931)	8
Mayer v. *Hellman*, 91 U.S. 496 (1876)	2, 3
In re State of Missouri v. *U.S. Bankruptcy Court*, 647 F.2d 768 (8th Cir. 1981)	2, 4, 5, 7, 9
Ogden v. *Saunders*, 25 U.S. (12 Wheat.) 213 (1827)	3
Parr v. *United States*, 351 U.S. 513 (1956)	10
Perez v. *Campbell*, 402 U.S. 637 (1971)	8
Probreslo v. *Joseph M. Boyd Company*, 287 U.S. 518 (1933)	3
Stellwagen v. *Clum*, 245 U.S. 605 (1918)	2, 3
Straton v. *New*, 283 U.S. 318 (1931)	3, 6, 8
Sturges v. *Crowninshield*, 17 U.S. (4 Wheat.) 122 (1819)	1, 2
Re Watts, 190 U.S. 1 (1903)	8

Page(s)

United States Constitution:

Article I, Section 8, Clause 4 (Bankruptcy Clause) . 2

Statutes and Rules:

Bankruptcy Code of 1978:

Section 105 8

Section 105(a) 8

Section 541 ..... 3, 5, 7, 8

Section 541(a)(1) 2, 4

United States Code:

Title 28 Section 1471(e) 2, 5

Revised Statutes of Missouri:

§ 411.519.1 3

§ 411.519.2 3

§ 411.519.6 3

Miscellaneous:

House Rep. No. 95-595 7

IN THE

Supreme Court of the United States

October Term, 1981

No. 81-79

IN RE STATE OF MISSOURI, et al.,

Petitioners,

—v.—

UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF ARKANSAS and the HONORABLE CHARLES W. BAKER, et al.,

Respondents.

PETITIONERS' REPLY TO BRIEF FOR THE UNITED STATES

The brief for the United States, just as the Eighth Circuit's decision, is predicated on two incorrect assumptions: first, that state court proceedings under the Missouri grain law constitute "insolvency" proceedings; and second, that federal bankruptcy actions preempt state "insolvency" proceedings.

Those assumptions are shattered by almost two centuries of case law beginning with the seminal opinion of Chief Justice Marshall in *Sturges* v. *Crowninshield*, 17 U.S. (4 Wheat.) 122 (1819) where he stated that while Congress "possesses the power of enacting bankrupt laws, . . . the states [have] the power of enacting insolvent laws." 17 U.S. at 194.

The contentions of the United States and the Eighth Circuit's decision are in conflict with time-honored decisions of this Court establishing (1) that state proceedings, such as those under the Missouri grain law, are not "insolvency" proceedings, and (2) that "insolvency" proceedings, unlike "bank-

ruptcy" proceedings that provide for the *discharge* of the debtor, are not preempted by federal bankruptcy. They also incorrectly assert that under Bankruptcy Code § 541(a)(1) and 28 U.S.C. § 1471(e) the bankruptcy court had jurisdiction over all of the subject grain, claiming it was part of the "estates" of the debtors as of the commencement of these bankruptcy cases even though the debtors then had neither possession of the grain nor a right to use or enjoy it. However, the United States joins petitioners in rejecting the Eighth Circuit's holding, 647 F.2d at 776, that state court proceedings that are otherwise immune from federal bankruptcy are superseded by the federal proceedings if they relate to the protection of *pecuniary* interests. U.S. Br., p. 12, n.5.*

1. Neither the briefs for the United States or respondents, nor the Eighth Circuit's opinion, mentions the distinction between "bankruptcy" and "insolvency" proceedings made at the 1819 Term in *Sturges* v. *Crowninshield*, a distinction that serves as the cornerstone of the constitutional immunity of state "insolvency" and other non-bankruptcy proceedings from federal bankruptcy preemption. This Court there stated that *Congress*' power under the Bankruptcy Clause of the Constitution, Article I, Section 8, Clause 4, only encompassed the power to enact laws on the subject of "bankruptcies", and that the *states* had the power to enact "insolvency" laws. The Eighth Circuit assumed that Missouri's proceedings were "insolvency" proceedings. It then overlooked this basic distinction and held that as "insolvency" proceedings, Missouri's actions were preempted by federal bankruptcy. The United States agrees with these defective positions. U.S. Br., pp. 9, 11.

In essence, as established in *Sturges* v. *Crowninshield*, *supra*, 17 U.S. at 194, and as stated in many decisions during the ensuing century, a critical ingredient of a "bankruptcy" law is a *discharge* of the debtor that frees his after-acquired assets from his prior debts. *Mayer* v. *Hellman*, 91 U.S. 496 (1876); *Boese* v. *King*, 108 U.S. 379, 386-87 (1883); *Stellwagen* v. *Clum*, 245 U.S. 605, 615-17 (1918); *International Shoe Company* v.

* "U.S. Br." refers to the Brief for the United States in Opposition filed on or about December 14, 1981. "Pet." refers to the Petition for a writ of certiorari.

Pinkus, 278 U.S. 261, 264-65 (1929); *Straton* v. *New*, 283 U.S. 318, 327-28 (1931); *Pobreslo* v. *Joseph M. Boyd Company*, 287 U.S. 518, 523-24 (1933).

"Insolvency" laws, on the other hand, while dealing in various ways with debtors and their creditors, do not by discharge provide the debtor with the fresh start that is an essential element of a "bankruptcy" law. This distinction between the two types of laws was underscored at the 1827 Term in *Ogden* v. *Saunders*, 25 U.S. (12 Wheat.) 213 (1827). There, the Court stated that in operation, a "bankrupt" law "is to discharge the debtor absolutely." 25 U.S. at 302.

2. In actuality, the Missouri proceedings were neither "bankruptcy" nor "insolvency" proceedings. "Insolvency" proceedings not only do not grant a discharge, but must deal in some way with debtors and their creditors and at least bring about the liquidation of a *debtor's* assets and distribution to its creditors. Thus, a receivership for distribution of a debtor's property to his creditors may be an "insolvency" proceeding. *Stellwagen* v. *Clum*, *supra*, 245 U.S. at 613. On the other hand, assignments by debtors under state statutes of all of their assets for liquidation and distribution to the creditors, but which do not grant a discharge, may not be "insolvency" proceedings, although they may be attacked as preferences by the timely filing of a federal bankruptcy case against the assignor. *Mayer* v. *Hellman*, 91 U.S. 496, 503.

Missouri's grain law proceedings do not provide a discharge to the debtor warehouseman, nor do they wind up the debtor's business or distribute his assets to his creditors. Those proceedings merely authorize distribution of the stored grain to its *owners*. Proceedings under Missouri's grain laws affect only the owners of grain, i.e. hundreds of farmer-depositors, Pet. A-51, but do not involve any material interest in property of the debtors' § 541 estates. They were not "insolvency" proceedings.

Missouri's proceedings are triggered by various danger signals, such as the warehouseman's inability to satisfy depositors' grain claims or the warehouseman's insolvency, RsMo § 411.519.6, or a grain shortage, RsMo § 411.519.1 and .2. The statutory designation of a warehouseman's insolvency as a "trigger" does not transform Missouri's proceedings into "in-

solvency" proceedings for winding up the warehouseman's business to benefit his creditors. They retain their essential police power character to accomplish the grain law goals of protecting grain owners and the integrity of the grain industry.

3. Dominion and control over more than $5 million of grain here involved was voluntarily turned over to the Missouri authorities by the debtors on August 8, 1980, *prior* to filing their bankruptcy. The state authorities had possession on August 11, 1980, the date bankruptcy was filed. The grain therefore was not part of the debtors' "estate" created pursuant to § 541(a)(1). The United States has acknowledged that before commencement of these bankruptcy cases, the debtors authorized the Missouri authorities to assume control of their Missouri grain warehouses. U.S. Br., p. 5, n.2.* The Eighth Circuit also acknowledged that the debtors turned over such control *prior* to bankruptcy. 647 F.2d at 771. Nevertheless, the Eighth Circuit ruled that *in the absence of any state court order* on the date of Bankruptcy interfering with the debtors' right to possession, the debtors rather than Missouri would be treated as if they had a possessory interest in all of the grain on the date they filed their bankruptcy cases. 647 F.2d at 774, n.12 and text at n.12. In actuality, the Missouri authorities had possession prior to and on the date of the commencement of the bankruptcy cases. Pet. A-46, para. 7 and Pet. A-48, para. 15(a).

The existence of a possessory interest in the debtors was essential to the Eighth Circuit's analysis for two reasons: first, that court tried to prop up its unprecedented notion that there was "preliminary jurisdiction." To do so it fashioned a fictitious foundation consisting of a non-existent possessory interest. 647 F.2d at 774. Secondly, both the Eighth Circuit and the United States rely on § 541(a)(1) of the Bankruptcy Code that defines "property of the estate." That statute expressly includes as property of the estate only interests of the debtor in property "as of the commencement of the [bankruptcy] case." Without finding possession of the grain in the debtors *at that*

* Nevertheless, by inconsistent statement not supported by record citations, the United States erroneously states that the debtors had possession of the grain when they filed bankruptcy. U.S.Br., pp. 9 and 16.

date, the § 541 debtors' estate, otherwise possessing only a "minute" interest, could not be said to include the vast quantity of grain in issue. There thus would have been no basis under the language of 28 U.S.C. § 1471(e) or otherwise for an exercise of bankruptcy court jurisdiction over virtually all of the grain. Thus, absent actual possession by the debtors *on the date they filed bankruptcy*, there was no basis for concluding that the grain became part of the estate. Since the grain was not so possessed, it was not "property of the estate," and the bankruptcy court therefore lacked jurisdiction.

Tested by both the language and intent of § 541 of the Bankruptcy Code and 28 U.S.C. § 1471(e), its jurisdictional counterpart containing similar phraseology, the asserted conflict between state court proceedings under the Missouri grain law and the federal bankruptcy cases, evaporates. The state and federal proceedings were compatible. Each proceeding deals with *different* property—in one case the debtors', and in the other, the grain owners'. "Minute" interests and non-existent "possession" cannot move the $5 million of grain subject to the state proceedings into the category of "property of the estate" or "property of the debtor" at the date of bankruptcy. Indeed, there was never any real ownership or possessory interest of these estates in the grain. The Eighth Circuit even noted that "the trustee . . . presented no documents of title to substantiate his claim of ownership." 647 F.2d at 774. Thus, by judicial fiat, non-existent possession of the debtors at the date of bankruptcy was decreed to satisfy the requirement of actual possession mandated by the statute as the jurisdictional base.

4. In the present case, the jurisdiction of the Missouri state courts extended to all grain *not* owned by the debtors. The debtors merely owned 2.3% of the grain. 647 F.2d at 774. There was no dispute over the debtors' right to retain that "minute" portion of the grain. The purpose of the Missouri proceedings was to return close to 98% or roughly $5 million worth of grain to its hundreds of rightful owners. Those proceedings had nothing to do with the debtors as such or the claims of their creditors. Nor could those proceedings discharge the debtors from liability to their creditors. Missouri's proceedings thus were not "insolvency" proceedings in any sense.

Missouri's proceedings could not dispose of any property of the estates. But even if they could, they still would not be "insolvency" proceedings. It has been stated that "state laws which provide for sale and distribution of a debtor's property may not amount to insolvency laws." *Straton* v. *New*, *supra*, 283 U.S. at 327. This Court there ruled that the burden is on the party claiming that a state proceeding is an "insolvency" proceeding to establish that it is. Thus, the party making the assertion "must therefore show that the statutory action in the state court is, in fact, an insolvency proceeding." *Straton* v. *New*, *supra*, 283 U.S. at 327-28. No such showing has been made here. The United States and the Eighth Circuit merely assumed that they were "insolvency" proceedings.

5. Proceedings under state grain laws are not incompatible with bankruptcy proceedings of a warehouseman. The determination of the ownership of grain as among a large number of grain depositors has nothing to do with (a) any bankruptcy or insolvency proceedings of a debtor-warehouse company, (b) the distribution to creditors of such a debtor of the proceeds of the property actually included in the estate, such as the debtor's equipment or real estate, (c) adjudicating the allowance or disallowance of the claims of creditors of such a debtor, or (d) the discharge of such a debtor. Such state proceedings in reality have nothing to do with the purposes of a federal bankruptcy proceeding of a warehouseman or any other type of debtor.

The United States argues that a bankruptcy court would be crippled if its jurisdiction did not extend to "all of the property of the estate," relying on Congressional history. U.S. Br., pp. 9-10, n.4. Its argument, however, is a non-sequitur. No one disputes that in general the bankruptcy courts may exercise jurisdiction over property of the estate. The weakness in the contention of the United States is its endorsement of the unsupportable analysis of the Eighth Circuit (1) treating property not owned by the estates and in which they had no possessory interest entitling them to use or enjoy it, as if it were property of the estate and (2) treating property in the possession of the Missouri authorities on the date of bankruptcy as if the debtors themselves then had possession of it.

Neither any demonstrated impact of the state proceedings on the federal bankruptcy proceedings nor any statute or case law supports the broad reading of the statutes regarding the bankruptcy courts' jurisdiction for which the United States contends. No precedent or policy has been advanced to extend the jurisdiction of bankruptcy courts to enormous quantities of property *not* owned by the debtors. The United States erroneously argues that "only the bankruptcy court was authorized by Congress to determine these competing [ownership] claims" among third parties. U.S. Br., p. 11. No support has been offered for its *ipse dixit* that state court jurisdiction over such claims would interfere with the orderly administration of the bankruptcy. Moreover, any ownership disputes are among third parties. Under applicable case law, such disputes belong in the state courts. Supp. Br. dated August 12, 1981, p. 10; *accord*, *Matter of Emergency Beacon Corporation*, Slip Op. p. 5387, at 5389, n.1 (2d Cir. November 23, 1981).

6. The lower court read § 541 as including in "property of the estate" grain delivered for storage to a warehouse debtor. Because the Congressional history of § 541 indicates that "a possessory interest or leasehold interest" would constitute property of the estate, the Eighth Circuit ruled, 647 F.2d at 774, and the United States now argues, U.S. Br., p. 9, that *bare possession* of property concededly deposited for storage is, without more, a "possessory interest" included in the § 541 estate. However, bare possession by a mere bailee, without an associated right of use or enjoyment of the property, is not sufficient to elevate naked possession to the level of a "possessory interest" of the type included in the § 541 estate. A bailee has no right of use akin to the possessory interest enjoyed by a debtor-lessee under a lease, and is more like a mere stakeholder. Moreover, the Congressional history of § 541 makes clear that not all property possessed by a debtor automatically becomes part of his § 541 estate. For example, property held by a debtor under a constructive trust is not included. H.Rep. No. 95-595, p. 368. No sound reason has been advanced for treating as property of the estate property that is neither owned by the estate nor dedicated to its use or enjoyment. The lower

court's analysis, and the United States' argument, regarding § 541 is erroneous.

7. The brief of the United States, as the decision below, advances § 105(a) of the Bankruptcy Code to bootstrap its conclusion that the bankruptcy proceedings preempted the state court proceedings. See U.S. Br., p. 14 and 647 F.2d at 776. However, § 105 merely confers authority on a bankruptcy court to issue orders, process or judgments as "necessary or appropriate to carry out the provisions" of the Bankruptcy Code. Since the debtors lacked any ownership or other interest sufficient to bring almost 98% of the grain within their estates, it was neither necessary nor appropriate for the bankruptcy court to issue any order enjoining the Missouri state court proceedings in order to carry out the provisions of the Bankruptcy Code. In short, jurisdiction could not be created or expanded by § 105(a).

8. The United States, echoing respondents and the Eighth Circuit, relies on *Re Watts*, 190 U.S. 1, 27 (1903). U.S. Br., p. 9. In *Straton* v. *New*, *supra*, 283 U.S. at 331, this Court narrowed *Re Watts* on the basis of a statement in *Re Watts* that a bankruptcy proceeding may displace the state court proceedings only if the state proceedings took the form "of winding up the affairs of the insolvent corporation." 283 U.S. at 331. Missouri's proceedings were not to wind up the debtors' affairs. *Re Watts* is inapposite.

Isaacs v. *Hobbs Tie & Timber Company*, 282 U.S. 734, 737-38 (1931), relied on in concert by respondents, the United States and the Eight Circuit, also has nothing to do with this case. *Isaacs* merely held that since a court of bankruptcy "has exclusive jurisdiction to deal with the property of the bankruptcy estate," a state foreclosure court should not interfere with such jurisdiction by further proceedings for foreclosure. 282 U.S. at 737. The predicate of that case was jurisdiction over "property of the bankrupt estate." As shown above, virtually none of the grain was "property of the estate" under § 541. *Perez* v. *Campbell*, 402 U.S. 637 (1971), is even further afield. It ruled that state statutes that "interfere with" federal statutes are invalid under the Supremacy Clause. The state statute there involved withheld a discharge that would have

been available under the Bankruptcy Act. The inconsistency was obvious. No inconsistency exists in the present case; it has only been assumed.

9. Faced with intimidation by respondents, threats of force by the United States marshalls, and contempt proceedings noticed personally by the bankruptcy judge, petitioners were under no duty concurrently to seek relief from respondents themselves. Case law sanctioned the initiation by state governmental officials of proceedings for a writ of prohibition to confine the bankruptcy court to its lawful jurisdiction. Supp. Br. dated August 12, 1981, p. 1, n.* Petitioners were not required first to subject themselves to prosecution for contempt and likely punishment by a bankruptcy judge who aggressively undertook contempt proceedings against officials of the State of Missouri, 647 F.2d at 773, and then to take an appeal "if dissatisfied with the result." 647 F.2d at 779. In an extraordinary case such as this, state officials are not required to risk jail sentences for criminal contempt in order to obtain judicial relief confining an inferior federal court to its lawful jurisdiction. The United States echoes the claim that an appeal was available. U.S. Br., p. 15. However, no case it cites would opt for appeal rather than an extraordinary writ in these circumstances. Pet. A-57.

Feelings ran high among the hundreds of farmer-depositors in Missouri. The climate was tense and dangerous because of the bankruptcy court's order requiring various farmer-depositors to sell new grain to the bankruptcy trustee, while they were told at the same time that they could not get possession from the trustee of their own previously deposited grain. 647 F.2d at 772, n.7. Tension escalated even more when the bankruptcy court called out United States marshalls to break the farmers' blockade. 647 F.2d at 772, n.7. Bloodshed was a risk. Had Missouri's authorities submitted to the disputed jurisdiction of the bankruptcy court and then sought relief on appeal from adverse rulings, the likelihood of force and bloodshed would have increased because of the open hostility of the farmer-depositors to the bankruptcy authorities. Missouri's proceedings for writs of prohibition, on the other hand, tended to dissipate

that hostility. The circumstances of this case were extraordinary.

The cases relied on by the United States to deny extraordinary relief are either inapposite or support petitioners. For example, *Parr* v. *United States*, 351 U.S. 513, 520, (1957), U.S. Br., p. 14, actually sanctioned a writ where, as here, "a court has exceeded . . . its jurisdiction." 351 U.S. at 520. In *Ex parte The City Bank of New Orleans* (cited by the United States as *Ex parte Christie*) 44 U.S. (3 How.) 292, 308-322 (1845), it was merely ruled that a court of bankruptcy had jurisdiction to determine creditor claims, the function there challenged. 44 U.S. at 320. That case thus has no bearing on this one. Nor does *Chandler* v. *Judicial Council of the Tenth Circuit*, 398 U.S. 74, 86 (1970) bear on the present case. There, the petitioners had other available legal means that were adequate. Further, the bankruptcy court's lack of jurisdiction could not be cured by waiver, estoppel, inaction or otherwise. Reply brief dated September 14, 1981, pp. 8-9.

CONCLUSION

For the reasons stated above, in their petition, and in their prior briefs dated August 12, 1981, September 14, 1981 and December 3, 1981, petitioners respectfully request that this Court issue a writ of certiorari and reverse the Eighth Circuit's judgment.

Respectfully submitted,

JOHN ASHCROFT
Attorney General

MICHAEL H. FINKELSTEIN
Assistant Attorney General

P.O. Box 899
Jefferson City, Missouri 65102
(314) 751-3321

Attorneys for Petitioners

Of Counsel:

RICHARD LIEB
KRONISH, LIEB, SHAINSWIT, WEINER & HELLMAN
1345 Avenue of the Americas
New York, New York 10105
(212) 841-6000

Dated: December 23, 1981